Overview of Business Activity Tax Simplification Act of 2005

In the face of revenue shortfalls, some states have become more aggressive in seeking new ways to tax the business community. With respect to the business activity tax, some states are using the theory of an "economic nexus"-that an out-of-state business can have nexus with a state without establishing any physical presence there, based only on entering into an economic transaction with a customer in the state (e.g., merely by selling goods or licensing intangible property (such as a trademark or software) to a customer in the state). H.R. 1956, the Business Activity Tax Simplification Act of 2005, would bring certainty to today's unpredictable tax environment for businesses by-

¨ Establishing "physical presence" as the nexus standard for levying business activity taxes on tangible or intangible goods which travel in interstate commerce;

¨ Generally requiring a business to use employees or services in a state for more than 21 days in a calendar year to establish physical presence, with exemptions for certain activities, such as newsgathering, meetings with government officials and participation in educational and training seminars; and

¨ Amending P.L. 86-272, enacted in 1959, which limits the power of states to impose net income taxes on tangible goods which travel in interstate commerce, to cover:

intangible property and services; and

state and local business activity taxes in addition to net income taxes,

so long as the only activity in the state is soliciting orders for sales.

Underlying principles:

¨ Certainty: Creates a bright line rule to determine when an out-of-state business is required to pay business activity taxes to a state.

¨ Modernity: Updates P.L. 86-272 to cover intangible property and services and business activity taxes, neither of which was a concern in 1959.

¨ Fairness: States and localities which provide meaningful services to a business, such as education, roads and fire and police protection, should receive the benefit of that business' taxes, rather than a remote state which provides no services to the business.

Need for legislation: Examples of the harmful application of business activity taxes include-

¨ New Jersey has argued that a mom-and-pop South Carolina software company with annual sales of approximately $100,000 and which has no physical presence in any states besides South Carolina and Georgia, owes a $500 per year minimum corporate tax and a $100 per year corporate registration fee based only on the sale of licensed software to a New Jersey entity, even for those years in which the company's annual revenue from customers in the state was as low as $49.

¨ The Louisiana Department of Revenue has threatened to assess business activity taxes on several out-of-state companies based on the fact that those companies broadcast programming into the state, arguing that the companies are exploiting the Louisiana market because the programming is seen or heard by individuals in Louisiana.

¨ The Tennessee Department of Revenue attempted to assess business activity taxes on an out-of-state credit card company based solely on the presence of the credit cards in its jurisdiction and the "substantial privilege of carrying on business" in the state.

¨ A Minnesota law would have authorized assessment of business activity taxes against any out-of-state health care provider which provides care to 20 or more Minnesotans or which solicits business from potential customers in Minnesota, even when the health care is provided outside of Minnesota.

¨ According to one survey, 16 states assert that an out-of-state company with nothing more than a website on someone else's server in a state has a sufficient connection to the state to justify imposing business activity taxes on the out-of-state company. The same survey indicates that 11 states believe that an out-of-state company that lists a telephone number in a local phone book located in the state has a sufficient nexus with the state to justify taxation.

¨ A survey shows that eight states take the position that a business whose trucks merely pass through the state six or even fewer times in a year-without picking up or delivering goods-have sufficient connections with the state to justify imposing business activity taxes on that company.